require all incumbent local exchange carriers that wish to offer telemessaging services to do so through a separate affiliate in order to meet the goals of section 260.[133]

55. MCI and Voice-Tel contend that telemessaging is an information service, and that when a BOC provides telemessaging on an interLATA basis, it must do so in accordance with the section 272 separate affiliate requirements.[134] Certain local exchange carriers argue that section 272 only requires that interLATA information services, not intraLATA information services such as many existing telemessaging services, be offered through a separate affiliate.[135] BellSouth asserts that the requirement of a separate subsidiary for the provision of interLATA information services facially violates incumbent local exchange carriers' First Amendment right to freedom of speech.[136]

Discussion:

56. We concur with the incumbent local exchange carriers that assert that our existing accounting safeguards will effectively prevent cross-subsidization of telemessaging services in accordance with section 260(a)(1). We presently classify telemessaging service as a nonregulated activity for Title II accounting purposes.[137] Consequently, costs associated with the provision of telemessaging services are already addressed by our Part 64 cost allocation rules and, to the extent telemessaging is provided through affiliates, our affiliate transactions rules also apply.[138] Our Part 64 rules require carriers to allocate a portion of their network investment plant used to provide telemessaging services to nonregulated accounts.

57. We find unpersuasive Voice-Tel's assertion that existing accounting safeguards in Parts 32 and 64 cannot ensure that telemessaging services that are marketed and provided by incumbent local exchange carriers on an in-house basis will not be subsidized by ratepayers. Our Part 64 cost allocation rules require local exchange carriers providing services in addition to local exchange service to use a cost allocation methodology based on fully distributed costs

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[133] Id. at 12-13.

[134] MCI Comments at 11; Voice-Tel Comments at 13; but see PacTel Comments at 10.

[135] Bell Atlantic Reply at 8; BellSouth Reply at 14; NYNEX Reply at 8.

[136] BellSouth Comments at 14-15.

[137] See note 120, supra.

[138] See note 2, supra.

("FDC").[139] This methodology establishes a hierarchy of cost apportionment rules designed to prevent cross-subsidies. These rules are applied to costs recorded in the accounts specified in the Uniform System of Accounts ("USOA") set out in Part 32 of our rules.[140] The methodology requires carriers to assign costs directly, wherever possible, to regulated or nonregulated activities.[141] If costs cannot be directly assigned, they are considered "common costs" and must be placed in homogenous cost pools.[142] The carrier must then divide the costs in each pool between regulated and nonregulated activities using formulas or factors known as "allocators." Depending upon the information available, carriers must apply these allocators in the following order. Whenever possible, common costs must be directly attributed based upon a direct analysis of the origins of those costs. Common costs that cannot be directly attributed must be indirectly attributed based on an indirect, but cost-causative, linkage to another cost pool or pools for which a direct assignment or attribution is possible.[143] Only if direct or indirect attribution factors are not available may the carrier allocate a pool of common costs using what is known as a "general allocator." Our Part 64 cost allocation rules are designed to prevent cross-subsidization of nonregulated activities such as telemarketing by establishing a methodology for allocating joint and common costs such as those described by Voice-Tel between regulated and nonregulated activities.

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[139] A fully distributed costing system allocates all of the costs of a group of services among those services using direct assignment and allocation factors based on relative use or estimates of relative use. The assignments and allocations determine each service's share of total cost. See MCI Telecommunications Corp. v. FCC, 675 F.2d 408, 410 (D.C. Cir. 1982); Joint Cost Order, 2 FCC Rcd at 1312-13 paras. 109-117.

[140] 47 C.F.R. Part 32.

[141] Costs are directly assigned when they can be traced to a service or activity without the use of an allocator.

[142] "Homogenous cost pools" are comprised of logical groupings of similar costs that maximize the extent to which cost-causative allocation factors can be used to divide the costs between regulated and nonregulated activities. See Joint Cost Order, 2 FCC Rcd at 1319 para. 164.

[143] "Direct attribution occurs when common costs are allocated between regulated and nonregulated activities based on direct measures of cost causation or direct analysis of the origin of the costs themselves. For example, if motor vehicle investment is apportioned between regulated and nonregulated based on analysis of the usage of those motor vehicles, the costs are directly attributed. Indirect attribution occurs when common costs are allocated between regulated and nonregulated activities based on indirect measures of cost-causation. For example, if investment in garage work equipment is apportioned between regulated and nonregulated activities in proportion to the overall apportionment of motor vehicle investment, the costs are indirectly attributed." Implementation of Further Cost Allocation Uniformity, Order Inviting Comments, AAD 92-42, 7 FCC Rcd 6688, 6689 para. 9 (Com. Car. Bur. 1992).

58. Our cost allocation and affiliate transactions rules have been in place for approximately ten years. As already observed, these rules and procedures, in combination with audits, tariff review, and the complaint process, have proven successful at protecting regulated ratepayers from bearing the risks and costs of incumbent local exchange carriers' competitive ventures.[144] Since the inception of our Part 64 cost allocation rules, the types of nonregulated activities have continued to grow. The Commission designed the cost allocation system in such a way that it can accommodate the evolving nature of nonregulated activities, such as telemessaging services. Thus, we conclude that our current rules protect local exchange service subscribers from subsidizing telemessaging services that are marketed and provided by incumbent local exchange carriers on an integrated basis.

59. Based upon the analysis set forth in our companion item, the *Non-Accounting Safeguards Order*, we adopt our tentative conclusion that telemessaging is an information service.[145] We also adopt, as we do in our companion item, our tentative conclusion that BOCs providing telemessaging services that meet the definition of interLATA information services must comply with the section 272 separate affiliate requirements, in addition to the section 260 requirements.[146]

60. BellSouth has argued that requiring BOCs to provide out-of-region interLATA information services through a section 272 separate affiliate violates the First Amendment.[147] As noted above, we find that this result is required by the Act. Although the courts have ultimate authority to determine the constitutionality of this and other statutes, we find it appropriate to state that we find BellSouth's argument to be without merit.[148] BellSouth bases its argument on an assertion that information services are commercial speech entitled to First Amendment protections.[149] We conclude, first, that with respect to certain information services, a BOC neither provides, nor exercises editorial discretion over, the content of the information associated with those particular services, and therefore provision of those

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[144] See discussion in section II.B., infra.

[145] Non-Accounting Safeguards Order at para. 145.

[146] Id. One example of a telemessaging service that is an interLATA information service might be a voicemail service that is bundled with a personal 800 number for access.

[147] BellSouth Comments at 14-15.

[148] The Commission has previously offered its opinion on the constitutionality of other statutory provisions. See Inquiry into Section 73.1910 of the Commission's Rules and Regulations Concerning the General Fairness Doctrine Obligations of Broadcast Licensees, 102 F.C.C. 2d 143, 155-156 para. 18 (1985).

[149] BellSouth Comments at 14.

information services does not constitute speech subject to First Amendment protections.[150] Second, to the extent that BOC provision of other interLATA information services constitutes speech for First Amendment purposes, the section 272 separate affiliate requirement neither prohibits the BOCs from providing such services, nor places any restrictions on the content of the information the BOCs may provide.[151] Instead, the section 272 separate affiliate requirement is a content-neutral restriction on the manner in which BOCs may provide interLATA information services, intended by Congress to protect against improper cost allocation and discrimination concerns. Thus, we conclude that the separate affiliate requirement imposed by section 272 of the Communications Act on BOC provision of interLATA information services does not violate the First Amendment.[152]

2. Section 271 - InterLATA Telecommunications Services

61. The *NPRM* noted that section 272(a)(2)(B) permits BOCs to provide on an integrated basis certain regulated, interLATA telecommunications services, including out-of-region services and certain types of incidental services.[153] In our *Interim BOC Out-of-Region Order*,[154] we determined that the BOCs must provide out-of-region interstate, interexchange services (including interLATA and intraLATA services) through separate affiliates, at least on an interim basis, in order to qualify for non-dominant regulatory treatment in the provision of those services. Under the *Interim BOC Out-of-Region Order*, however, a BOC could still choose to provide these services on an integrated basis, subject to dominant carrier regulation.[155] Accordingly, this Order addresses the cost allocation rules that should be

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[150] Cf. Turner Broadcasting System, Inc. v. FCC, 114 S. Ct. 2445, 2456 (1994).

[151] Like the must-carry rules at issue in Turner Broadcasting System, the section 272 separate affiliate requirement "on [its] face impose[s] burdens and confer[s] benefits without reference to the content of speech." Turner Broadcasting System, 114 S. Ct. at 2460.

[152] Content-neutral time, place, and manner restrictions that serve a substantial government interest are constitutionally permissible. See, e.g., City of Renton v. Playtime Theatres, Inc., 475 U.S. 41, reh'g denied, 475 U.S. 1132 (1986).

[153] NPRM, 11 FCC Rcd at 9073 para. 39.

[154] Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, Report and Order, CC Docket No. 96-21, FCC 96-288 (rel. July 1, 1996) ("Interim BOC Out-of-Region Order").

[155] In the Interexchange NPRM the Commission asked whether we should modify or eliminate the separation requirements imposed on independent local exchange carriers other than the BOCs as a condition for non-dominant treatment of their interstate, domestic, interexchange services originating outside their local exchange areas. Policy and Rules Concerning the Interstate, Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, Notice of Proposed Rulemaking, CC Docket No. 96-61, 11

applied to BOCs that choose to provide certain regulated, interLATA telecommunications services, including out-of-region services and certain types of incidental services, on an integrated basis.

a. Incidental InterLATA Services

62. Section 271(h) states that "[t]he Commission shall ensure that the provision of services authorized under [section 271(g)] by a Bell operating company or its affiliate will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market."[156] In the *NPRM*, we sought comment on whether our present Part 64 cost allocation rules are adequate to prevent the adverse effects proscribed by section 271(h) with respect to incidental interLATA services.[157] We asked commenters to describe in detail the modifications or additions to Part 64 they believe necessary, to explain how these modifications or additions would better enable the Commission to fulfill its obligations under section 271(h), and to identify the category of ratepayers or markets the proposed modifications or additions would protect.

Comments:

63. Incumbent local exchange carriers generally assert that our current cost allocation rules are adequate to "ensure that the provision of services authorized under [section 271(g)] by a Bell operating company or its affiliate will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market" in accordance with section 271(h).[158]

64. Worldcom contends that the language of section 271(h) strongly implies that the Commission's current cost allocation rules are not adequate to ensure that the BOC's provision of incidental interLATA services would not adversely affect ratepayers and competitors.[159]

FCC Rcd 7141, 7174 (1996) ("Interexchange NPRM"). The Commission also sought comment on whether, if we modify or eliminate these separation requirements for independent local exchange carriers, we should apply the same requirements to BOC provision of out-of-region interstate, domestic, interexchange services. Id.

156 47 U.S.C. § 271(h).

157 NPRM, 11 FCC Rcd at 9073 para. 38.

158 Ameritech Comments at 20; BellSouth Comments at 16; PacTel Comments at 10; US West Comments at 5.

159 Worldcom Comments at 14; Worldcom Reply at 9.

Worldcom asserts that at a minimum we should apply the same cost allocation requirements to incidental interLATA services as are applied to other interLATA services provided by the BOCs on an integrated basis.[160]

Discussion:

65. We incorporate our conclusions regarding the accounting safeguards necessary to prevent the adverse effects proscribed by section 271(h) with respect to the integrated provision of incidental interLATA services by the BOCs in our discussion of accounting safeguards to be applied to BOC provision of interLATA services. That discussion appears in Section III.B.2.b. below.

b. Integrated Provision of InterLATA Services

66. The *NPRM* tentatively concluded that we should apply our Part 64 cost allocation rules to regulated services other than local exchange and exchange access services, including out-of-region services and certain types of incidental services, provided by BOCs on an integrated basis in accordance with section 272(a)(2)(B).[161] We invited comment on this tentative conclusion. We also asked whether we needed to develop different cost allocation rules for these regulated services other than local exchange and exchange access to prevent allocation of the costs of such regulated services to local exchange and exchange access customers.[162] We suggested two possible solutions: (1) the creation of a separate category for Title II accounting purposes to include regulated services other than local exchange and exchange access services,[163] or (2) the classification of any regulated services other than local

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[160] Worldcom Comments at 14.

[161] NPRM at para. 39.

[162] In section IV.B.4, infra, we discuss the application of affiliate transactions rules to transactions between the BOCs and any of their affiliates engaged in activities, other than out-of-region interLATA services, that are permitted under section 271 of the Communications Act of 1934.

[163] The creation of a separate category for Title II accounting purposes would result in subaccounts for regulated local exchange and exchange access services and for regulated services other than local exchange and exchange access services. This would parallel the approach we took with respect to video dialtone in Telephone Company-Cable Television Cross Ownership Rules, Sections 63.54-63.58, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, CC Docket No. 87-266, 10 FCC Rcd 244, 326 para. 173 (1994) ("VDT Recon Order"). See Responsible Accounting Officer Letter 25, 10 FCC Rcd 6008 (Accounting and Audits Division, April 3, 1995), revoked by Implementation of Section 302 of the Telecommunications Act of 1996, Report and Order and Notice of Proposed Rulemaking, CS Docket 96-46, FCC 96-99 at para. 75 (rel. March 11, 1996).

exchange and exchange access services that are provided on an integrated basis as nonregulated activities for Title II accounting purposes.[164] We invited comment on these solutions.

67. In the *NPRM*, we asked whether, if incumbent local exchange carriers provide out-of-region interstate interexchange services on an integrated basis, our accounting rules for such incumbent local exchange carriers should be similar to those we adopt for the BOCs.[165]

Comments:

68. Many parties support our proposal to apply our Part 64 cost allocation rules to regulated interLATA telecommunications services, including out-of-region services and certain types of incidental services, that may be provided by BOCs on an integrated basis and contend that such services should be treated like nonregulated activities for federal accounting purposes.[166] In particular, TRA maintains that treating such services like nonregulated activities for federal accounting purposes will lessen the chance that costs associated with such services are inadvertently assigned to a local exchange or exchange access category.[167] Worldcom asserts that the potential for improper cost allocation is greater between two regulated categories than between regulated and nonregulated activities.[168]

69. SBC argues that it would be improper to treat all incidental interLATA services like nonregulated activities for federal accounting purposes because a number of the activities that these incidental interLATA services support would be regulated Title II activities.[169] SBC contends that the costs of such incidental services are supposed to flow through the Part 36 process to separate integrated plant serving state and interstate jurisdictions.[170]

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[164] This would parallel the approach we took in the Interim BOC Out-of-Region Order where we determined that out-of-region interstate, interexchange services provided by BOC affiliates should be treated like nonregulated services for accounting purposes. Interim BOC Out-of-Region Order at paras. 38-40.

[165] NPRM, 11 FCC Rcd at 9074 para. 40.

[166] AT&T Comments at 19; CTA Comments at 10; GSA Comments at 4; Sprint Comments at 9; TRA Comments at 25-26; Worldcom Comments at 13. See also NYNEX Comments at 14.

[167] TRA Comments at 26.

[168] Worldcom Comments at 13.

[169] SBC Comments at 20-21.

[170] Id. at 21.

70. MCI proposes that, as in the *Video Dialtone Proceeding*, we should create a separate category for Title II accounting purposes to include regulated services other than local exchange and exchange access services in order to clearly identify the allocation of costs between a BOC's local and interLATA operations.[171] In contrast, the BOCs generally argue that no separate regulated category is needed for interLATA telecommunications services provided on an integrated basis, such as out-of-region services and certain types of incidental services, because our current accounting safeguards rules ensure that ratepayers do not subsidize interexchange operations.[172] In particular, several of the BOCs assert that Part 36 will separate the costs of these services into state and interstate portions, and Part 69 will allocate the costs of all regulated, interLATA telecommunications services to the interexchange basket separate from local exchange and exchange access costs.[173] BellSouth and PacTel argue that there is also no need to treat these services like nonregulated activities for federal accounting purposes because the Commission can review the costs of providing such services, including the allocation of overhead, during the tariff review process.[174]

71. Several parties contend that we should require all incumbent local exchange carriers, including non-BOCs, to treat any regulated services other than local exchange and exchange access like nonregulated services for Title II accounting purposes to ensure the prevention of subsidies flowing from the latter services to the former.[175]

72. Cincinnati Bell and USTA argue that sections 271 through 276 apply solely to BOCs and the Commission has no authority to apply additional accounting safeguards to non-BOC incumbent local exchange carriers.[176]

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[171] MCI Comments at 14.

[172] BellSouth Comments at 16; PacTel Comments at 10; US WEST Comments at 5. See also Ameritech Comments at 20; NYNEX Reply at 5; PacTel Comments at 11; SBC Comments at 22; USTA Comments at 20.

[173] Ameritech Comments at 20; PacTel Comments at 11; USTA Comments at 20; NYNEX Reply at 5; but see AT&T Reply at 13.

[174] BellSouth Comments at 16; PacTel Comments at 10.

[175] GSA Comments at 4; TRA Comments at 25; AT&T Reply at 12.

[176] Cincinnati Bell Comments at 3; USTA Comments at 3.

Discussion:

73. Section 254(k) prohibits a "telecommunications carrier" from using "services that are not competitive to subsidize services that are subject to competition."[177] We conclude that section 254(k) bars all incumbent local exchange carriers, including BOCs, from subsidizing competitive interLATA telecommunications services, such as out-of-region services and certain types of incidental interLATA services, with revenues from exchange services and exchange access that are not subject to competition. Section 271(h) specifically requires the Commission to ensure that the provision of incidental interLATA telecommunications services by a BOC or its affiliate "will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market."[178] Accordingly, we concur with the parties that assert that our Part 64 cost allocation rules should apply to interLATA telecommunications services, including out-of-region services and certain types of incidental services, that may be provided by incumbent local exchange carriers on an integrated basis.

74. Our Part 64 cost allocation rules require a carrier to assign costs directly, wherever possible, to regulated or nonregulated activities. These rules protect subscribers to interstate exchange and exchange access services from bearing the costs and risks of the carrier's nonregulated activities provided on an integrated basis. These rules do not, however, protect against improper cost allocations from one regulated activity to another regulated activity. Therefore, if interLATA telecommunications services, including out-of-region services and certain types of incidental services, that may be provided by incumbent local exchange carriers on an integrated basis, were treated as regulated for accounting purposes, our Part 64 rules would not prevent any improper cost allocations that may occur between local exchange and exchange access services and these interLATA telecommunication services.

75. For these reasons, we agree with TRA, GSA and AT&T that under our current cost allocation rules we can most efficiently and comprehensively satisfy sections 254(k) and 271(h) if, solely for federal accounting purposes, we treat like nonregulated activities both out-of-region and certain types of incidental interLATA services that may be provided by incumbent local exchange carriers on an integrated basis. We believe that this should sufficiently safeguard against cross-subsidization without imposing additional accounting requirements on carriers. This would parallel the approach taken in the *Interim BOC Out-of-Region Order* that classified out-of-region interstate, interexchange services provided by BOC affiliates as nonregulated activity for accounting purposes.[179] Because incumbent local

[177] 47 U.S.C. § 254(k).

[178] Id. § 271(h).

exchange carriers currently have internal accounting systems in place to allocate costs fairly between nonregulated activities and regulated services provided on an integrated basis, such a requirement will not impose extensive expense upon incumbent local exchange carriers.[180]

76. We agree with several of the BOCs that assert that Part 36 will jurisdictionally separate the costs of regulated, interLATA telecommunications services into state and interstate portions, and Part 69 will allocate the costs of all regulated interstate, interLATA telecommunications services to the interexchange basket separate from local exchange and exchange access costs. We conclude, however, that the Part 36 jurisdictional separations process and the Part 69 access charge process were not designed to prevent subsidization of competitive telecommunications services by subscribers to exchange and exchange access services. Although the Part 36 and Part 69 processes produce the secondary effect of assigning the costs of regulated interstate, interLATA telecommunications services to the interexchange basket, classifying both out-of-region and certain types of incidental interLATA services as nonregulated activities for federal accounting purposes will achieve greater accuracy in safeguarding against cross-subsidization. Classifying such services as nonregulated activities allows the allocation of costs for these activities to occur immediately after such costs are assigned to Part 32 accounts. Such treatment avoids the necessary imprecisions inherent in the Part 36 jurisdictional separations process, the Part 69 access charge process, and our Part 61 price cap rules. Moreover, we concur with TRA that treating such services like nonregulated activities for federal accounting purposes will lessen the chance that costs associated with such services are inadvertently assigned to a local exchange or exchange access category.

c. Other Matters

77. Section 272(e)(3) requires that "[a] Bell operating company . . . impute to itself (if using [exchange] access for its provision of its own services), an amount for access that is no less than the amount charged to any unaffiliated interexchange carriers for such service."[181] In the *NPRM*, we invited comment on how BOCs should account for these access charges.[182] The *NPRM* suggested that one possible approach would be for BOCs to record these imputed exchange access charges as an expense that would be directly assigned to nonregulated

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179 Interim BOC Out-of-Region Order at paras. 38-40.

180 Cf. id. at para. 40.

181 47 U.S.C. § 272(e)(3) (emphasis added).

182 NPRM, 11 FCC Rcd at 9075 para. 41.

activities with a credit to the regulated access revenue account. We invited comment on this approach as well as alternative approaches.

78. Section 272(e)(4) states that "[a] Bell operating company and an affiliate that is subject to the requirements of section 251(c) . . . may provide any interLATA or intraLATA facilities or services to its interLATA affiliate if such services or facilities are made available to all carriers at the same rates and on the same terms and conditions, and so long as the costs are appropriately allocated."[183] In the *NPRM*, we invited comment on whether and, if so, how the requirements of sections 272(e)(3) and (4) should affect our rules for allocating costs between activities regulated under Title II and nonregulated activities for those BOCs that provide interLATA services on an integrated basis.[184] We also requested comment on whether, in light of section 272(e)(4), we may require BOCs that provide interLATA or intraLATA facilities or services on an integrated basis to provide these facilities or services to their own internal operation only at the same rates as those facilities or services are made available to all carriers. When those rates differ for different carriers, we sought comment on which rate should be applicable to BOC affiliate transactions. We also invited comment on whether we should adopt specific accounting procedures to address the difference, if any, between those rates and the costs that would be appropriately allocated for the underlying facilities or services.

Comments:

79. AT&T and Worldcom agree with the tentative conclusion in the *NPRM* that BOCs should record imputed exchange access charges as an expense that would be directly assigned to nonregulated activities with a credit to the regulated access revenue account.[185] In general, incumbent local exchange carriers disagree with the tentative conclusion stated in the *NPRM*.[186] In particular, PacTel contends that the approach suggested in the *NPRM* is only workable for structurally separate affiliates where revenues and expenses of the BOC and its affiliate are each stated correctly for regulated reporting purposes (each entity separately reports the results of its own operations).[187] US West and GSA argue that recording imputed

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[183] 47 U.S.C. § 272(e)(4).

[184] NPRM, 11 FCC Rcd at 9075 para. 42.

[185] AT&T Comments at 19; Worldcom Comments at 15.

[186] Ameritech Comments at 21; US West Comments at 7; GSA Reply at 7. See also Bell Atlantic Comments at 16; NYNEX Comments at 15; PacTel Comments at 12-13; NYNEX Reply at 6.

[187] PacTel Comments at 12.

access charges as a nonregulated expense might result in a doubling of overhead costs allocated to the nonregulated activity because the imputed charge would already contain an element of overhead.[188]

80. Several incumbent local exchange carriers argue that we should require imputed access charges to be recorded as debits to nonregulated revenues and credits to regulated access charge revenues.[189] In general, incumbent local exchange carriers maintain that section 32.5280 of our rules defines the accounting treatment for regulated services provided on an integrated basis: "[the nonregulated operating revenue] account shall be debited, and regulated revenue accounts credited at tariffed rates when tariffed services are provided to nonregulated activities."[190]

81. NYNEX contends that imputing exchange access charges is not necessary because treating interexchange service as nonregulated would trigger the application of the Part 64 requirement that nonregulated services record the use of the underlying tariffed services at tariff rates, satisfying section 272(e)(3)'s requirements and ensuring against cross-subsidization.[191]

82. AT&T and Worldcom assert that we must ensure that the full access charge is reflected in a BOC's end-user rates, and is not merely a book entry in the case of a BOC that uses exchange access for the provision of its own services.[192] AT&T argues that in order to ensure that the full access charge is reflected in a BOC's end-user rates, we should establish price floors at a level equal to the amount of the access charge plus the incremental cost of the non-access portions of the service.[193] Wisconsin PSC states that it presently makes use of price floors such that when a carrier subject to Wisconsin PSC's regulations uses a noncompetitive service in the provision of its own competitive service, the competitive service must be priced to exceed total service long-run incremental cost ("TSLRIC").[194] Accordingly,

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188 US West Comments at 7; GSA Reply at 7.

189 Ameritech Comments at 21; Bell Atlantic Comments at 16; PacTel Comments at 12-13; US West Comments at 7; GSA Reply at 7; NYNEX Reply at 6.

190 47 C.F.R. § 32.5280(b). See Ameritech Comments at 21; BellSouth Comments at 17; PacTel Comments at 12-13; SBC Comments at 24; US West Comments at 7; NYNEX Reply at 6; USTA Reply at 7.

191 NYNEX Comments at 15.

192 AT&T Comments at 19; Worldcom Comments at 15-16.

193 AT&T Comments at 19; but see NYNEX Reply at 6.

like AT&T, Wisconsin PSC argues that we should adopt a price floor to prevent cross-subsidization.[195]

83. With respect to whether the requirements in sections 272(e)(3) and (e)(4) should affect our rules for allocating costs between activities regulated under Title II and nonregulated activities for those BOCs that provide interLATA services on an integrated basis, SBC argues that sections 272(e)(3) and (e)(4) relate solely to in-region interLATA services that BOCs are required to provide through an affiliate and are not relevant to the interLATA services that the BOCs are permitted to provide on an integrated basis.[196]

84. TRA and Worldcom argue that when a BOC charges different rates to different unaffiliated carriers for facilities or services, the BOC must impute the highest rate paid for the same facilities or services to the BOC's integrated operations.[197] USTA, however, alleges that an approach requiring the BOC's integrated operations to pay the highest rate paid for the same facilities or services by unaffiliated carriers would unnecessarily constrain a BOC from volume discount purchases.[198]

85. Bell Atlantic and US West assert that what local exchange carriers charge for interLATA services is not an accounting issue, but rather a pricing issue and has no place in this proceeding.[199]

Discussion:

86. We conclude that we should not require BOCs to record imputed exchange access charges required under section 272(e)(3) as an expense that would be directly assigned to nonregulated activities with a credit to the regulated access revenue account. We conclude that the approach suggested in the *NPRM* would result in an overstatement of operating revenues. Instead, we concur with the BOCs that the logic of section 32.5280 of our rules provides the proper framework for recording imputed exchange access charges.[200]

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194 Wisconsin PSC Comments at 12.

195 Id. at 13. See also Florida PSC Reply at 4-5.

196 SBC Comments at 24-25.

197 TRA Comments at 26; Worldcom Comments at 17.

198 USTA Reply at 8.

199 Bell Atlantic Comments at 16; US West Reply at 12.

Accordingly, to record imputed exchange access charges required under section 272(e)(3), BOCs should debit the nonregulated operating revenue account by the amount of the imputed exchange access charges and credit the regulated revenue account by the amount of the imputed exchange access charges. By requiring BOCs to account for imputed exchange access charges in this manner, the accounting for this imputed revenue will be consistent with our current accounting rules adopted in the *Joint Cost Proceeding* for imputing revenues derived from services provided to nonregulated affiliates.[201]

87. Section 272(e)(3) requires a BOC to impute to itself an amount for access it provides to its telephone exchange service "that is no less than the amount charged to any unaffiliated interexchange carriers for such service."[202] Accordingly, where a BOC charges different rates to different unaffiliated carriers for access to its telephone exchange service, the BOC must impute to its integrated operations the highest rate paid for such access by unaffiliated carriers. In determining the highest rate paid by unaffiliated carriers, the BOC may consider the comparability of the service provided. If, for example, rates charged unaffiliated carriers vary based on the volume purchased, the BOC may consider comparable volume in determining the highest rate to impute to its integrated operations. Accordingly, a BOC's integrated operations may take advantage of the same volume discount purchases offered to its interLATA affiliate and other unaffiliated carriers.[203] As for AT&T's and Worldcom's concerns regarding the reflection of the full access charge in a BOC's end-user rates, we agree with Bell Atlantic and US West that those concerns involve pricing issues, rather than accounting issues, and therefore lie beyond the scope of this proceeding.[204]

3. Section 275 - Alarm Monitoring Services

88. Section 275(e) defines "alarm monitoring service" as "a service that uses a device located at a residence, place of business, or other fixed premises (1) to receive signals from other devices located at or about such premises regarding a possible threat at such premises to life, safety, or property, from burglary, fire, vandalism, bodily injury, or other emergency, and (2) to transmit a signal regarding such threat by means of transmission facilities of a local exchange carrier or one of its affiliates to a remote monitoring center to

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200 See 47 C.F.R. § 32.5280.

201 See Joint Cost Reconsideration Order, 2 FCC Rcd at 6307 para 208.

202 47 U.S.C. § 272(e)(3).

203 See Non-Accounting Safeguards Order at para. 257.

204 Id.

alert a person" about the emergency.[205] Section 275(a)(1) delays entry by the BOCs not already providing alarm monitoring services until five years from the date of enactment of the 1996 Act.[206] If a BOC or BOC affiliate provided alarm monitoring services as of November 30, 1995, it may continue to do so, but cannot expand its alarm monitoring business by acquiring "any equity interest in, or obtain financial control of, any unaffiliated alarm monitoring service entity" during the five-year period after the date of enactment of the 1996 Act.[207]

89. Section 275(b)(2) specifies that an incumbent local exchange carrier engaged in the provision of alarm monitoring services "not subsidize its alarm monitoring services either directly or indirectly from telephone exchange service operations."[208] As with the prohibition against subsidizing telemessaging services, this prohibition against subsidizing alarm monitoring services specifically applies to incumbent local exchange carriers.[209]

90. In the *NPRM*, we asked whether our present Part 64 cost allocation rules are necessary or sufficient to prevent subsidization of alarm monitoring services either directly or indirectly from telephone exchange service operations in accordance with section 275(b)(2).[210]

Comments:

91. Commenters generally agree that the Commission's present Part 64 cost allocation rules are sufficient to prevent subsidization of alarm monitoring services from telephone exchange service operations because alarm monitoring services are presently treated as nonregulated activities for Title II accounting purposes and the Commission's Part 64 cost allocation rules require carriers to allocate the costs of alarm monitoring services to

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[205] 47 U.S.C. § 275(e).

[206] Id. § 275(a)(1).

[207] Id. § 275(a)(2).

[208] Id. § 275(b)(2).

[209] The provisions of the 1996 Act prohibiting the subsidy of alarm monitoring services "apply to incumbent exchange carriers rather than to all common carriers." S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 42 (1996).

[210] NPRM, 11 FCC Rcd at 9079 para. 53.

nonregulated activities.[211] SBC believes that the language of section 275 does not require the imposition of any accounting safeguards with respect to alarm monitoring services.[212]

Discussion:

92. We concur with the numerous commenters that assert that application of our present Part 64 cost allocation rules to alarm monitoring services will adequately safeguard against the subsidies prohibited by section 275(b)(2) because our rules require that the fully distributed cost of providing alarm monitoring service be removed from the carrier's regulated activities. We presently classify alarm monitoring services as nonregulated activities for Title II accounting purposes. Consequently, our cost allocation rules and affiliate transaction rules apply to alarm monitoring services. Carriers are required to allocate a portion of their network investment plant used to provide alarm monitoring services to these nonregulated activities. We already have experience with the application of our existing rules to alarm monitoring services because some companies already provide alarm monitoring services on a nonregulated basis.

4. Section 276 - Payphone Services

93. Section 276(a)(1) states that "any Bell operating company that provides payphone service shall not subsidize its payphone service directly or indirectly from its telephone exchange service operations or its exchange access operations."[213] This prohibition against cross-subsidization is an integral part of the statutory plan "to promote competition among payphone providers and promote the widespread deployment of payphone services to the benefit of the general public."[214] To implement the prohibition, section 276(b)(1)(C) directs the Commission to prescribe nonstructural safeguards for BOC payphone service that, "at a minimum, include the nonstructural safeguards equal to those adopted in the Computer Inquiry-III (CC Docket No. 90-623) proceeding."[215] In *Computer III*, we examined our regulatory regime for the provision of enhanced services and replaced the *Computer II* requirements with a series of nonstructural safeguards. These safeguards included the Part 64

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[211] MCI Comments at 15. See also AICC Comments at 3-4; Ameritech Comments at 21; USTA Comments at 21; US West Comments at 9.

[212] SBC Comments at 16.

[213] 47 U.S.C. § 276(a)(1).

[214] Id. § 276(b)(1).

[215] Id. § 276(b)(1)(C).

cost allocation rules and the affiliate transactions rules that we developed in the *Joint Cost Order*.

94. In the *NPRM*, we tentatively concluded that we should apply accounting safeguards identical to those adopted in the *Computer III* proceedings to prevent the cross-subsidization of payphone services by BOC telephone exchange service or exchange access operations in accordance with sections 276(a)(1) and (b)(1)(C).[216] We invited comment on this tentative conclusion.

95. The provision of payphone service by local exchange carriers has traditionally been treated as a regulated activity for Title II accounting purposes.[217] In the *NPRM*, we tentatively concluded that we should reclassify payphone service as a nonregulated activity for accounting purposes so that its costs will be separated from telephone exchange service and exchange access operations.[218] Under this proposal, BOCs would classify their payphone investment, expenses and revenues as nonregulated for Title II accounting purposes while continuing to use the Commission's Part 32 accounts to record their payphone service activities. We invited comment on this tentative conclusion and asked whether this proposal would provide nonstructural accounting safeguards equivalent to those adopted in the *Computer III* proceeding and whether such changes would prevent subsidization of payphone services by BOC telephone exchange service or exchange access operations.

96. Section 276 does not prescribe accounting safeguards to govern the provision of payphone service by incumbent local exchange carriers other than the BOCs. We also asked in *NPRM* whether we should require non-BOC incumbent local exchange carriers to reclassify their payphone service operations as a nonregulated activity for Title II accounting purposes.[219]

Comments:

97. In general, BOCs and interexchange carriers contend that payphone service should be treated like a nonregulated activity for federal accounting purposes.[220] Several

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[216] NPRM, 11 FCC Rcd at 9081 para. 58.

[217] See 47 C.F.R. §§ 32.2351, 32.6351, 32.6623, 32.5010.

[218] NPRM, 11 FCC Rcd at 9081 para. 59.

[219] Id. at 9082 para. 60.

[220] Ameritech Comments at 21-22; CTA Comments at 11; PacTel Comments at 14; Sprint Comments at 9; US West Comments at 10; Worldcom Comments at 19. See also APCC Reply at 1-2.

BOCs assert that adoption of the *Computer III* safeguards is sufficient to prevent cross-subsidization of payphone services.[221] Coalition argues that section 276(b) specifically identifies the nonstructural safeguards in *Computer III* as an appropriate standard.[222] MCI maintains that any new safeguards or revisions adopted pursuant to our reconsideration of *Computer III* on remand should also apply to the provision of payphone service.[223]

98. Worldcom, CTA and APCC argue that *Computer III* safeguards are insufficient to satisfy section 276.[224] APCC asserts that our *Computer III* safeguards were devised to incorporate concerns regarding efficiency that are outside the realm of section 276.[225] APCC also contends that incumbent local exchange carriers have dominated the payphone industry for some time and their payphone operations have traditionally benefitted from cross-subsidization.[226] Accordingly, APCC concludes that stronger safeguards are needed in the payphone context.[227]

99. Several parties maintain that the *Computer III* safeguards should be applied to all incumbent local exchange carriers providing payphone service.[228] APCC contends that any proposed accounting safeguard should apply, at a minimum, to all incumbent local exchange carriers with greater than $100 million in annual revenues, as well as local exchange carriers serving island territories such as Puerto Rico and the Virgin Islands.[229]

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[221] Ameritech Comments at 21; BellSouth Comments at 19; NYNEX Comments at 16; SBC Comments at 17.

[222] Coalition Reply at 5.

[223] MCI Comments at 15. See also US West Comments at 9.

[224] APCC Comments at 3; CTA Comments at 11; Worldcom Comments at 19; Worldcom Reply at 10.

[225] APCC Comments at 4.

[226] Id.; but see Coalition Reply at 10.

[227] APCC Comments at 4.

[228] MCI Comments at 15. See also California Comments at 10; GSA Comments at 4.

[229] APCC Comments at 5, n. 4.

Discussion:

100. The Commission reclassified pay telephone service as a nonregulated service in the *Pay Telephone Reclassification Order*.[230] As a result, carriers must apportion payphone service costs to nonregulated and common cost pools, ensuring that subscribers to interstate exchange services and exchange access do not bear the costs and risks of the carrier's payphone service. Our *Pay Telephone Reclassification Order* also requires that BOCs and incumbent local exchange carriers providing payphone service on an integrated basis follow the nonstructural safeguards described in *Computer III* in order to provide sufficient protection against the possibility that payphone service could be subsidized by local exchange service or exchange access operations.[231] The nonstructural safeguards in *Computer III* include our Part 64 cost allocation rules and our Part 32 affiliate transactions rules adopted in the *Joint Cost Order*. This requirement satisfies both the prohibition against cross-subsidization in section 276(a)(1) and the requirement in section 276(b)(1)(C) that we adopt a set of nonstructural safeguards at least equal to those adopted in *Computer III*. Although Worldcom, CTA and APCC argue that *Computer III* safeguards are insufficient to satisfy section 276, these parties offer no substitute safeguards to implement the requirements of section 276. Our experience with accounting safeguards in *Computer III* has demonstrated that these safeguards can effectively guard against the subsidization of competitive activities by regulated ratepayers, which section 276 prohibits. In fact, section 276(b) specifically identifies the *Computer III* safeguards as the appropriate standard for nonstructural safeguards regarding payphone service.[232] Accordingly, we adopt our tentative conclusion that we should apply accounting safeguards identical to those adopted in *Computer III* to BOCs and incumbent local exchange carriers providing payphone service on an integrated basis.

IV. SAFEGUARDS FOR SEPARATED OPERATIONS

A. General

101. Section 272(a)(2) allows BOCs to provide the following services only through a separate subsidiary: the sale of telecommunications equipment and manufacturing of telecommunications equipment and customer premises equipment;[233] origination of interLATA

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230 See Pay Telephone Reclassification Order at para. 157.

231 Id. at paras. 157, 199, 201.

232 See 47 U.S.C. § 272(b).

telecommunications services, other than incidental, out-of-region, and previously authorized services; and interLATA information services other than electronic publishing and alarm monitoring services.[234] Section 273(d)(3) requires "any entity which certifies telecommunications equipment or customer premises equipment manufactured by an unaffiliated entity . . . only [to] manufacture a particular class of telecommunications equipment or customer premises equipment for which it is undertaking or has undertaken, during the previous eighteen months, certification activity for such class of equipment through a separate affiliate."[235] Section 274(a) requires that BOCs providing electronic publishing must do so only through a "separated affiliate" or electronic publishing joint venture.[236] These requirements for "separate" or "separated" affiliates or joint ventures implicitly assume that structural safeguards limit the carrier's ability to engage in cross-subsidization and discrimination, and enhance the ability of the Commission or a State to detect cross-subsidization and discrimination.

102. In the *NPRM*, we tentatively concluded that, except where the Act imposes specific additional requirements, our current affiliate transactions rules generally satisfy the Act's requirements on safeguards to ensure that the services that section 272, 273 and 274 require BOCs to provide through a separate or "separated" affiliate are not subsidized by subscribers to regulated telecommunications services.[237] We invited comment on this tentative conclusion as well as whether the benefits of any fundamentally different approach to affiliate transactions would be outweighed by the costs that implementation of such a system would entail.

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[233] Pursuant to section 273(h), "manufacturing has the same meaning as such term has under the AT&T Consent Decree." Id. § 273(h).

[234] Id. § 272(a)(2).

[235] Id. § 273(d)(3). Section 273(d)(8)(D) defines "certification" as "any technical process whereby a party determines whether a product, for use by more than one local exchange carrier, conforms with the specified requirements pertaining to such product." Id. § 273(d)(8)(D).

[236] Id. § 274(a). Section 274(h)(1) generally defines electronic publishing to mean the "[dissemination], provision, publication, or sale to an unaffiliated entity or persons" of certain enumerated services, such as news, entertainment, business, financial and legal information. Section 274(h)(2) exempts from the definition of electronic publishing various services, like e-mail, language translation services and network services upgrades. Id. §§ 274(h)(1), 274(h)(2).

[237] NPRM, 11 FCC Rcd at 9083-84 para. 64.

103. We also sought comment in the *NPRM* on whether we should modify our affiliate transactions rules in certain respects.[238] In 1993, we released an *Affiliate Transactions Notice* proposing certain rule changes, including changes in how subject carriers would value for Title II accounting purposes services they provide, or receive from, nonregulated affiliates in order to provide more complete protection against cross-subsidization.[239] In the *NPRM*, we invited comment on whether, in implementing the Act's provisions regarding cross-subsidization, we should amend the current affiliate transactions rules to incorporate certain of the modifications proposed in the *Affiliate Transactions Notice* or any other changes. We also sought comment on whether the affiliate transactions rules we adopt in this proceeding should apply to all transactions between incumbent local exchange carriers and their affiliates, or simply to entities that engage in activities for which the Act requires the use of a separate or separated subsidiary.[240]

Comments:

104. Most parties support our tentative conclusions that our current affiliate transactions rules generally satisfy the Act's requirements except where amendments made by the 1996 Act impose specific additional requirements.[241] In particular, AT&T contends that existing accounting rules could be extended to new separated operations with a minimum of disruption because incumbent local exchange carriers have already implemented internal accounting systems designed to ensure compliance with the Commission's existing accounting rules.[242] MCI, however, maintains that we must adopt more stringent affiliate transactions rules to account for the increased opportunities for BOCs to enter new lines of nonregulated businesses and for the increased incentives and opportunities for incumbent local exchange

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[238] Id. at 9084 para. 65.

[239] See Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions Between Carriers and Their Nonregulated Affiliates, CC Docket No. 93-251, Notice of Proposed Rulemaking, 8 FCC Rcd 8071, 8076 para. 9 (1993) ("Affiliate Transactions Notice").

[240] 47 U.S.C. §§ 272-74.

[241] AT&T Comments at 8; California Comments at 7; CTA Comments at 14; Puerto Rico Telephone Comments at 3; SBC Comments at 26; Sprint Comments at 10; TRA Comments at 5; US West Comments at 10. See also PacTel Comments at 10. We note that our discussion in section V.A. of this Order addresses the BOCs' arguments that, though adequate, the affiliate transactions rules are no longer necessary because of price cap regulation with no sharing.

[242] AT&T Comments at 8.

carriers to shift costs.[243] Specifically, MCI argues that we should adopt a rule requiring carriers to maintain a complete audit trail for all cost allocations and affiliate transactions.[244]

105. TIA sets forth three justifications for strengthening the affiliate transactions rules in the manner described in the *NPRM*. First, TIA contends that the Commission has had almost a decade of experience with the existing affiliate transactions rules and that the Commission found the current rules to be inadequate as far back as 1993 in its *Affiliate Transactions NPRM*.[245] Second, TIA alleges that a number of recent State and federal audits have indicated improper allocations of costs by the BOCs under the current rules.[246] Finally, TIA contends that the removal of the MFJ's restrictions on BOC entry into competitive markets has increased the risk of cross-subsidization.[247]

106. The BOCs generally oppose the modifications to the affiliate transactions rules that we proposed in the *NPRM*.[248] They assert that any benefits of new or modified affiliate transactions rules would be outweighed by the costs of implementing these new or modified rules.[249] In particular, SBC maintains that parties advocating additional and more detailed affiliate transactions rules have not provided sufficient justification to outweigh the increased burden that would result.[250] SBC and US West contend that, if we decide to modify our affiliate transactions rules, we should apply those modifications only to transactions involving BOCs and their section 272 separate affiliates.[251]

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[243] MCI Comments at 3.

[244] MCI Comments at 9. See also Ohio Reply at 4; TIA Reply at 25.

[245] TIA Reply at 15.

[246] Id.

[247] Id. at 16.

[248] Ameritech Comments at 14; NYNEX Comments at 19-20; PacTel Comments at 2; SBC Comments at 26; USTA Comments at 16; US West Comments at 10.

[249] See PacTel Comments at 16; SBC Comments at 27-28; USTA Comments at 16; US West Comments at 10.

[250] See SBC Comments at 19; SBC Reply at 10.

[251] SBC Comments at 39; US West Comments at 11.

Discussion:

107. In the *Joint Cost Order*, we adopted rules to govern how costs are recorded, for Title II accounting purposes, when a regulated carrier does business with nonregulated affiliates.[252] These affiliate transactions rules were designed to protect ratepayers from subsidizing the competitive ventures of incumbent local exchange carriers' affiliates. The affiliate transactions rules do not require carriers or their affiliates to charge any particular price for assets transferred or services provided; rather, the rules require carriers to use certain specified valuation methods in determining the amounts to record in their Part 32 accounts, regardless of the prices charged.[253]

108. In agreement with most commenters,[254] we adopt our tentative conclusion that, except where the 1996 Act imposes specific additional requirements,[255] our current affiliate transactions rules generally satisfy the statute's requirement of safeguards to ensure that these services are not subsidized by subscribers to regulated telecommunications services.[256] We have previously concluded that these rules provide effective safeguards against cross-subsidization.[257] Moreover, incumbent local exchange carriers have already implemented internal accounting systems for affiliate transactions to help ensure compliance with these rules. These systems have proven generally effective and we see no reason to require a change to a different system.

109. While we decline to alter our prescribed accounting treatment of affiliate transactions, we do adopt several of the modifications to the affiliate transactions rules initially proposed in the *NPRM*. We now have had approximately ten years experience with the cost allocation and affiliate transactions regime created by the *Joint Cost Order*. This experience has convinced us that amending certain aspects of the affiliate transactions rules would provide more complete protection against cross-subsidization.[258] We first presented in the 1993

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252 See Joint Cost Order, 2 FCC Rcd at 1335-37 paras. 290-301.

253 See 47 C.F.R. § 32.27.

254 See, e.g., AT&T Comments at 8; California Comments at 7; TRA Comments at 5.

255 See, e.g., section IV.B.1.b., infra.

256 47 U.S.C. §§ 260, 272-76.

257 Computer III Remand, 6 FCC Rcd at 7591 para. 46.

258 See Affiliate Transactions Notice, 8 FCC Rcd at 8076 para. 9. See also TIA Reply at 15.

Affiliate Transaction Notice some of the proposed modifications incorporated in our *NPRM*. We discuss these modifications and present our rationale for adopting or rejecting them below. We note that modifications that we make to improve the affiliate transactions rules will apply to all transactions between incumbent local exchange carriers currently subject to these rules and their affiliates, not just to transactions between a BOC and an affiliate required under the Act.[259]

B. Specific Services

1. Section 272 - Manufacturing and InterLATA Services

a. Statutory Language

110. Section 272(a) prohibits a "Bell operating company (including any affiliate) which is a local exchange carrier that is subject to the requirements of section 251(c)" from "provid[ing] any service described in [section 272(a)(2)] unless it provides that service through one or more affiliates that (A) are separate from any operating company entity that is subject to the requirements of section 251(c); and (B) meet the requirements of [section 272(b)]."[260] Section 272(a)(2) states that:

> [t]he services for which a separate affiliate is required by [section 272(a)(1)] are: (A) [m]anufacturing activities (as defined in section 273(h)); (B) [o]rigination of interLATA telecommunications services, other than (i) incidental interLATA services described in [section 271(g)(1)-(3) and (5)-(6)]; (ii) out-of-region services described in section 271(b)(2); or (iii) previously authorized activities described in section 271(f); [and] (C) [i]nterLATA information services, other than electronic publishing (as defined in section 274(h)) and alarm monitoring services (as defined in section 275(e)).[261]

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[259] For example, as discussed in section IV.B.4., infra, the Act does not require a non-BOC incumbent local exchange carrier to use an affiliate to provide telemessaging services. We conclude, however, that our affiliate transactions rules should apply to transactions between a non-BOC incumbent local exchange carrier and any affiliate that it has chosen to create to provide telemessaging services. This Order also mandates application of the affiliate transactions rules to transactions between an incumbent local exchange carrier and its affiliate not engaged in services specifically addressed in sections 260 and 271 through 276.

[260] 47 U.S.C. § 272(a)

[261] Id. § 272(a)(2).

Section 272(b)(2) requires each of these separate affiliates to "maintain books, records, and accounts in the manner prescribed by the Commission which shall be separate from the books, records, and accounts maintained by the [BOC] of which it is an affiliate."[262] Under section 272(b)(5), each of these separate affiliates must "conduct all transactions with the [BOC] of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection."[263] Pursuant to section 272(c)(2), BOCs must account for all transactions with these affiliates "in accordance with accounting principles designated or approved by the Commission."[264]

b. "Arm's Length" Requirement of Section 272(b)(5)

111. Section 272(b)(5) requires that transactions between the BOC and its affiliates engaged in the manufacturing activities, origination of interLATA telecommunications services, and offering of interLATA information services described in section 272(a)(2) be conducted on "an arm's length basis."[265] In the *Computer II Final Decision,*[266] we required AT&T to provide enhanced services and customer premises equipment only through a "separate corporate entity" that would "deal with any affiliated manufacturing entity only on an *'arm's length'*" basis.[267] We stated that "the transfer of any products" between this separate corporate entity and "any affiliated equipment manufacturer must be done at a price that is compensatory."[268] In the *NPRM*, we asked commenters to address whether we should adopt requirements similar to those in the *Computer II Final Decision* in order to implement section 272(b)(5).[269] We also asked whether a requirement that all transfers of products between the

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[262] Id. § 272(b)(2).

[263] Id. § 272(b)(5).

[264] Id. § 272(c)(2).

[265] Id. § 272(b)(5).

[266] Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), Final Decision, Docket No. 20828, 77 FCC 2d 384 (1980) ("Computer II Final Decision"), recon., 84 FCC 2d 50 (1980), further recon., 88 FCC 2d 512 (1981), aff'd sub nom. Computer and Communications Industry Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983).

[267] Computer II Final Decision, 77 FCC 2d at 498 (emphasis added) (adopting section 64.702(c)(3) of the Commission's rules). See also id. at 482.

[268] Id. at 482.

[269] NPRM, 11 FCC Rcd at 9087 para. 70.